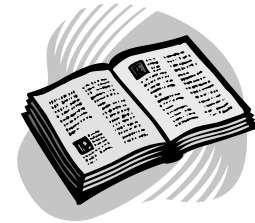


§ 313.837 Report on Competitiveness

Introduction

Section 313.837, RSMo. requires the Commission to report annually to the General Assembly “the status of the competitiveness of Missouri excursion gambling boats when compared to the gaming tax rate of adjoining states and the effects of the loss limits imposed by subdivision (3) of section 313.805 on the competitiveness of the gaming industry in Missouri.”



Effect of the Loss Limit on Competitiveness

The loss limit continues to be the source of the most frequent complaints of gaming patrons. Through reports from licensees and direct observations by Commission staff, it is clear that a large portion of riverboat gaming customers view the loss limit as intrusive, patronizing, frustrating, confusing and inconvenient.

Missouri operators continue to lag behind gaming operators in neighboring states with no loss limits. The shortfall exists despite expansion efforts and new property developments which have produced facilities that are larger, provide superior comfort and more non-gaming amenities than their competitors in other states. For the fifth consecutive year, the data clearly shows that the loss limit reduces customer counts and revenues for Missouri operators. The inconvenience of the loss limit results in the export of Missouri gaming customers to other states and the loss of potential gaming revenue from local gamers and tourists.



This proposition is supported not only by the chart on page 9, but also by the fact that Illinois riverboats are capturing a larger market share than that state’s population base represents. Missouri residents account for 76% of the St. Louis metropolitan area population base.¹ However, Missouri casinos in the St. Louis metropolitan area capture only 66% of the gaming revenue market.² This equates to an inequity of \$55.4 million in relation to gaming revenue and \$16.1 million in state and local taxes per year.

Furthermore, to put this data in a different perspective, it is unlikely that Illinois is capturing more than its share of the tourist market because of the proximity of the Missouri properties to the airport and downtown. In addition, the Missouri properties are more lavish and offer more non-gaming amenities than their Illinois competitors. Therefore, all other things being equal, the Missouri properties seem more likely to attract tourists. If this theory is correct, it must be assumed that almost all of the \$55.4 million inequity is a direct transfer of wealth from Missouri to Illinois. Regardless of the validity of this theory, it is irrefutable that Missouri gaming facilities, although generally superior

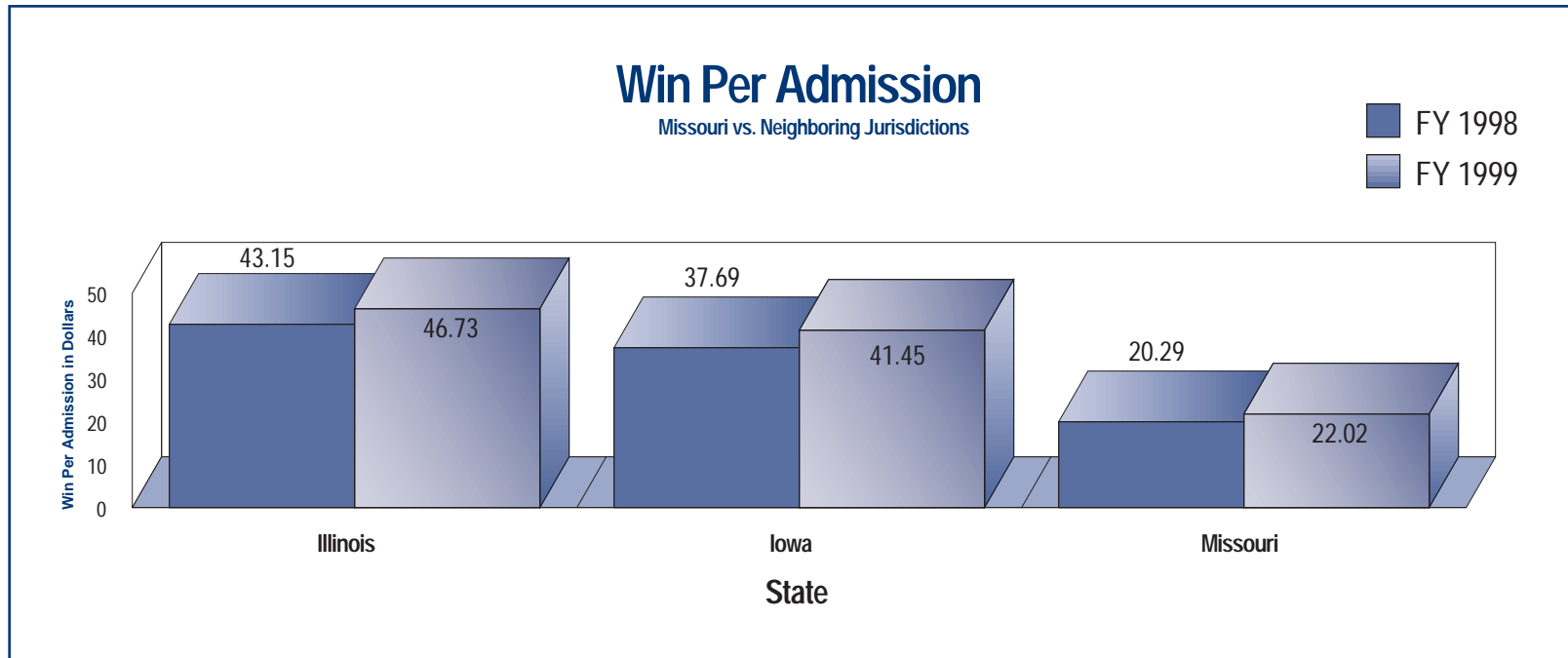
¹ Randy McNally Metropolitan Statistical Areas. January 1, 1997 estimate.

² Based on Missouri fiscal year 1999 data from the Illinois Gaming Control Board and the Missouri Gaming Commission.

in design and location, are not earning their fair share of the market.

The Commission understands that the General Assembly may have intended that Missouri gaming facilities operate at a competitive disadvantage in order to achieve a public policy objective advanced by the loss limit. If the public policy objective was to prevent patrons from becoming problem gamblers, it now seems appropriate to revisit the issue to determine if the policy is having its intended effect. As noted in the section on problem gambling later in this report, the Commission believes that further study is needed in order to determine the best method to deter, prevent and treat problem gambling.

The Commission is planning a program evaluation of its voluntary exclusion program for problem gamblers which may provide some insight into this issue. However, if the issues relating to problem gambling and the \$500 loss limit are to be fully examined, resources must be authorized to conduct a thorough study. This includes funding for research and a full time employee that administers and continually evaluates the voluntary exclusion program. The



Commission requests that the General Assembly appropriate money for such purposes consistent with the Commission's budget request that will be submitted later this year.

The above findings are intended to satisfy the Commission's statutory mandate to report annually to the General Assembly on the effects of the loss limit on the competitiveness of the gaming industry in Missouri. The enactment of any changes in policy as a result of these findings are obviously the purview of the General Assembly and the Governor.

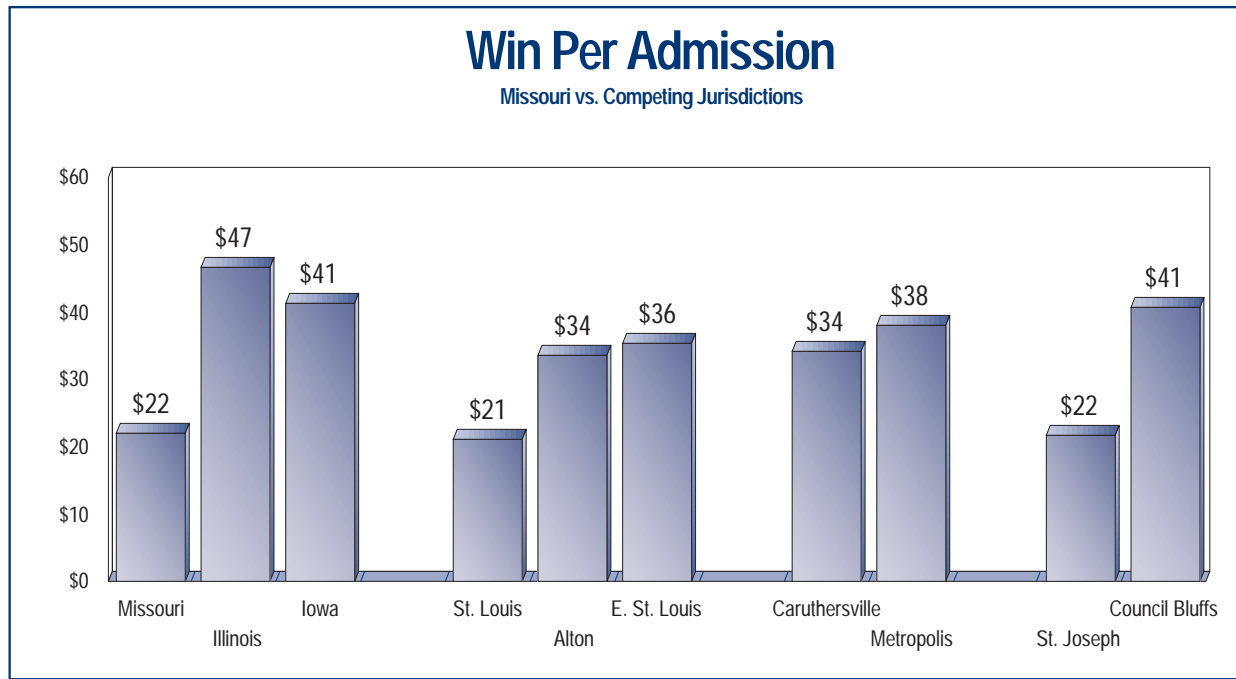
Competitive Impact of Missouri's Gaming Tax Rate

The gaming tax rates imposed on riverboat gaming operations in Missouri have not changed since the first licenses were issued in May 1994. Missouri law imposes an 18% tax on the adjusted gross receipts (AGR)³ of riverboat gaming operators. In addition, a local tax of 2% on AGR is collected by the state and distributed to each home dock city or county.⁴

The statute also imposes an admission fee on the operators of excursion gambling boats

³ Adjusted gross receipts are defined by Section 313.800, RSMo as "the gross receipts from licensed gambling games and devices less the winnings paid to wagerers." In other words, the amount the casino "wins" from patrons. It is often referred to as "casino win". The tax on AGR is set forth in Section 313.822, RSMo.

⁴ Section 313.822, RSMo.



in the amount of two dollars (\$2) per patron, per excursion, which is split between the home dock community and the state.⁵ Furthermore, pursuant to section 313.824, RSMo., excursion gambling boat operators are charged for the cost of gaming agents that are assigned to the riverboat with the responsibility of protecting the public. While the cost of Commission agents varies with each operation, the average annual cost is approximately \$578,179 per boat.

⁵ Section 313.820, RSMo.

The Overall Impact of Gaming Taxes and Fees

Riverboat gaming operators are taxed unlike any other business. The Commission's experience in responding to public information requests is that the gaming tax structure is not well understood. To put the gaming tax in perspective, consider the following example. If a gaming operator takes in \$1,000,000 in gross revenue, it must pay \$200,000 in gaming taxes.⁶ Assuming it required 50,000 admissions to accumulate \$1,000,000 in gross revenue, the operator would have to pay an additional \$100,000 in admission fees.⁷ Finally, the operator is responsible for the cost of the gaming agents assigned to that facility during the period that the \$1,000,000 is generated. Assume that the gaming agent cost is \$6,000, leaving \$694,000 in net revenue after gaming taxes, admission fees and gaming agent reimbursements. The operator must then pay all its expenses, such as outstanding debt on capital, employee salaries and benefits, utilities, marketing, local property tax, sales taxes and other business expenses related to the operation of the casino. After paying all the gaming taxes, fees and operating expenses, the casino must pay the applicable federal, state and local income taxes like any other business.

⁶ In this example, gross revenue is the same as AGR described in footnote 3 on page 10. It is the amount the casino "wins" from its patrons.

⁷ While a gaming operator may charge patrons for admission, it is not required by law. The casino is assessed \$2 per admission regardless as to whether it charges patrons for admission. In Missouri, most operators do not charge for admission.



Comparing the Missouri Tax Rate to Other Jurisdictions

Until recently, Missouri's gaming tax was structured almost identically to Illinois, the state that hosts its principal competitors. The Missouri tax rate is significantly higher than the Iowa rate and is difficult to compare to casino operations at Indian reservations in Kansas because revenue figures are not available and no taxes are assessed. The Missouri tax structure was originally patterned after the Illinois system. However, recent legislative changes have been enacted in Illinois that now significantly distinguish its tax rates from Missouri's.

Furthermore, the addition of more Indian casinos in Kansas has increased competition in the Kansas City and St. Joseph markets. While the Kansas Indian casinos face a disadvantage because of their less convenient locations, the fact that they pay no state taxes and do not have loss limits provide them with a tremendous advantage over their Missouri competitors.⁸ In addition, Indian tribes are attempting to secure permission to open casinos in Miami County,

⁸ Indian casinos are not regulated by any independent agency. Therefore, Indian casino operators do not have to pay for the cost of regulation, which is significant.

Kansas and at the Woodlands racing facility in Kansas. Both of these proposed sites have close proximity to casino operators in the Kansas City area and would have a substantial and immediate impact on jobs and state revenue.

Illinois Legislative Changes

During the past two legislative sessions, the Illinois legislature has enacted major changes to the riverboat gaming tax structure. In 1998, the flat 20% tax on adjusted gross receipts was abandoned in favor of a progressive scale ranging from 15% to 35% of gross revenue.⁹ In 1999, the legislature eliminated the stayover admission fee along with the cruising requirement.¹⁰ Illinois chose not to continue collecting stayover fees by eliminating phantom cruises similar to those conducted in Missouri, electing instead to assess only one \$2 fee per patron rather than a \$2 fee for each two hour “cruise”.¹¹

Effective Gaming Tax Rate

States that have legalized gaming have devised a variety of different taxes, fees and assessments that apply to casino operators. In addition, varying regulatory policies have a significant impact on the amount of revenue a casino operator generates. In order to compare the effects of such policy decisions, industry analysts and those who research public policy issues related to gaming have devised a simple formula to compare the public costs paid by gaming operators in various states. Commonly referred to as the “effective tax rate” the formula is simply the total of all gaming taxes, fees and assessments as a percentage of gross revenue.¹²

The effective tax rate is a helpful tool on at least two levels. First, it consolidates into one number all gaming taxes, fees and assessments that casino operators are required to pay. These expenses are typically separated in public report tables and it becomes difficult to evaluate the total costs being paid by a casino operator in order to maintain the privilege of being licensed. In addition, assessments against a licensee for various regulatory activities are often not reflected in the revenue reports that are distributed by the states.¹³ However, these costs can be significant and must be considered in evaluating the effect of taxes and regulations on the economic impact of gaming.

The effective tax rate is instructive in comparing the impact of varying state regulatory schemes on gaming revenues. When regulations limit the amount of revenue that a gaming

⁹ Illinois P.A. 90-548, 1998. The scale imposes a tax of 15% on AGR up to \$25 million; 20% between \$25 and \$50 million; 25% between \$50 and \$75 million; 30% between \$75 and \$100 million; and 35% over \$100 million.

¹⁰ SB 1017, Illinois General Assembly, 1999.

¹¹ Id.

¹² The formula does not include taxes and fees that are not unique to the gaming industry. Therefore, such things as state income or sales tax are not included.

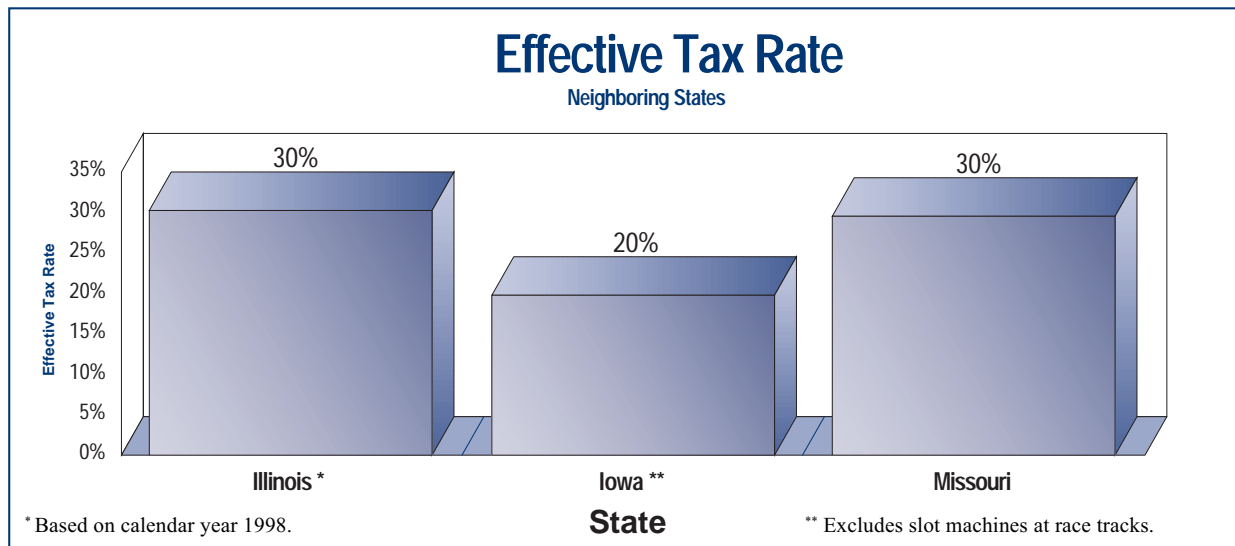
¹³ For instance, Section 313.824, RSMo. requires that the riverboat gambling operators reimburse the Commission for the full cost of the staff necessary to protect the public. Last year this resulted in an average annual cost of \$578,179 per licensee. However, these costs are not included in the revenue report issued by the Commission.

facility can generate, it will be reflected in the effective tax rate. Naturally, there are some instances, such as the \$500 loss limit in Missouri or the betting limits in Colorado or South Dakota, where the policy objective is intended to reduce revenue. In such cases, the effective tax rate is a useful tool in analyzing the cost of those policy objectives.

The effective tax rate is also a good indicator for evaluating many ramifications of tax policy. For instance, a good case can be made that graduated tax rates on gross casino revenue act as a deterrent to capital investment. When a company decides to commit additional capital to a casino property, it naturally expects to generate additional revenue to earn a reasonable return on its investment. However, if tax rates are graduated up, the casino company must consider the fact that any new injection of capital must generate substantially higher return than existing capital in order to cover the cost of the higher tax rate. The higher taxes will be reflected in the company's effective tax rate. While other market forces such as the quality of the operation, access to the property and demographics must be considered, the effective tax rate provides a good base comparison of state regulatory schemes.

The Competitiveness of the Missouri Tax Rate

As a result of the 1998 Illinois tax increase, Missouri's gaming tax rate on AGR is more conducive to capital investment and, in this respect, provides Missouri operators with an advan-



tage over their most direct competitor. Currently, Missouri properties generally enjoy a capital investment advantage over their Illinois competitors. The average investment of the properties in the St. Louis metropolitan area in Missouri is approximately \$125 million versus an estimated \$67.5 million in Illinois.¹⁴ The Missouri properties in the St. Louis area average 1,750 gaming positions in 52,250 square feet of gaming space as opposed to the Illinois average of 1,002 positions in 23,400 square feet. Furthermore, the Missouri properties have more non-gaming amenities than the facilities in Illinois.

However, any advantages gained through a lower AGR tax are diminished when considering that Illinois does not charge for the cost of Commission agents assigned to gaming facilities to protect the public and because of the 1999 legislative changes where the stayover admission fee was eliminated. To illustrate the impact of these changes, in Missouri fiscal year 1999, the Casino Queen and Alton Belle paid \$5,233,554 in stayover admission fees.¹⁵ These fees were eliminated on June 26, 1999, thus freeing the Illinois operators to utilize more money to make their facilities more attractive to patrons. The net result is that more Missourians are likely to spend their gambling dollar in Illinois and fewer Illini will travel to the more elaborate properties in Missouri. While the Illinois facilities will no longer be responsible for paying stayover admission fees, Missouri boats will continue to pay for stayover customers which resulted in payments from St. Louis area facilities of \$14,290,000 to state and local governments in fiscal year 1999.¹⁶

There have been no changes to the Iowa tax rate since the first Missouri gaming facilities were licensed in 1994. Because its graduated rate tops out at 20%, Iowa has a lower tax on AGR than Missouri. In addition, Iowa's admission fee is set by the Commission and designed only to cover the cost of regulation and provide some local revenue. Therefore, Iowa gaming facilities pay an average of \$1.40 less per admission than their Missouri competitors.

The Missouri tax rate is certainly one of the highest in the gaming industry. However, its structure has some inherent advantages over Illinois' and the lower tax rate in Iowa does not appear to be affecting the competitiveness of the Missouri operators. Certainly, over the long term, the fact that Kansas Indian casinos pay no tax will have an impact on western Missouri operators. Finally, because Missouri has chosen the gradual approach to licensure by waiting to introduce new gaming capacity into a market until there is some indication that it can be absorbed, the tax rate has been effectively managed by the Missouri casino licensees.

¹⁴ Because the Casino Queen is a private company, there are no officially reported capital investment figures. However, Prudential Securities estimates the investment to be \$90. Prudential Securities Investors Guide to U.S. Gaming Markets, Spring 1999 Edition, page 115.

¹⁵ Illinois Gaming Control Board reports. The Alton Belle had 921,791 stayover admissions, the Casino Queen had 1,694,986. Each stayover admission resulted in a \$2 fee, split between the host community and the state.

¹⁶ Even if a continuous boarding policy is adopted, Missouri casinos will continue to pay admission fees for stayover patrons. Statewide, stayovers accounted for \$33,891,026 in admission fees.